STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Illinois Bell Telephone Company	)	
	)	
Application for Review of Alternative Regulation Plan	)	ICC Docket No. 98-0252
	)	
Petition to Rebalance Illinois Bell Telephone Company's Carrier Access and Network Access Line Rates	)	ICC Docket No. 98-0335
	)	
Citizens Utility Board and People of the State of Illinois, ex rel. James E. Ryan, Attorney General of the State of Illinois, Complainants	)	ICC Docket No. 00-0764
vs.	)	
Illinois Bell Telephone Company d/b/a Ameritech Illinois, Respondent	)	(consolidated)

SECOND BRIEF ON EXCEPTIONS OF GCI/CITY

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INTRODUCTION

These exceptions are directed to the "Post Exceptions Proposed Order (Version 1)" ("PEPO"), which was issued after the effective date of the 2001 amendments to the Universal Telephone Service Protection Law of 1985 (HB 2900), and which was intended to incorporate the effect of those amendments. The People of the State of Illinois, by James E. Ryan, Attorney General (AG), the Citizens Utility Board (CUB), the City of Chicago (City) and the Cook County State's Attorney's Office (CCSAO), collectively Governmental and Consumer Intervenors and the City (GCI/City), submit that several of the changes made in the "PEPO" misconstrue the effect of the new law, and should be changed, as specified below.

In summary, the PEPO erroneously concludes that the General Assembly meant to shield the excessive earnings received by Illinois Bell Telephone Company (IBT) under the alternative regulation plan from review in this proceeding, and that no changes to IBT's rates should be made despite a return on common equity of 43%, 40.1% or 24.5%, as calculated by GCI/City, Staff and the Company, respectively. GCI/City Ex. 6.2 at 5; Staff Ex. 30, 30.1 and AI Ex. 7.3. It also unreasonably rejects the creation of a separate basket for the section 13-518 optional service packages. It misinterprets the effect of section 13-712 as a limitation on the Commission's authority to adopt service quality standards and penalties stricter than those contained in that Section and ignores Section 13-712(e)(6) which specifically states that the provisions of this section are cumulative and do not diminish other administrative remedies. Finally, its discussion of accounting issues, particularly directory revenues, which the General Assembly

addressed in amending section 9-230, is unreasonably abbreviated. The PEPO does not mention the section 9-230 revisions, and their effect on the analysis of IBT's revenues.

I. THE PEPO'S CONCLUSIONS THAT THE GENERAL ASSEMBLY INTENDED THAT THE COMMISSION NOT REVIEW THE COMPANY'S EARNINGS TO DETERMINE WHETHER THE PLAN PRODUCED JUST AND REASONABLE RATES IS BASED ON AN INCOMPLETE READING OF JUDICIAL PRECEDENT AND UNFOUNDED ASSUMPTIONS ABOUT LEGISLATIVE INTENT.

A. The Court In Reviewing The 1994 Alt. Reg. Order Did Not Hold That Earnings Are Irrelevant To Assessing The Success Of Alternative Regulation Or Its Compliance With The Fair, Just, And Reasonable Standard Of Section 13-506.1

The PEPO maintains that an examination of earnings to determine whether the rates produced under the alternative regulation plan are fair, just and reasonable "is inappropriate for alternative regulation." PEPO at 37. This misguided conclusion is repeated in the analysis of rate reinitialization at pages 145 through 148 of the PEPO. As new bases for the assumption that an earnings review and rate reinitialization are not viable since the adoption of the 1994 Order in ICC Docket 92-0448/93-0327, Oct. 11, 1994 ("1994 Alt. Reg. Order"), the PEPO cites an out-of-context quotation from the Second District Appellate Court's ruling in Illinois Bell Telephone Co. v. Illinois Commerce Commission, 283 Ill. App. 3d 188, 669 N.E.2d 919 (2d Dist. 1996)("Illinois Bell II"), and "recent action by the General Assembly," which, the ALJs assert, confirm the PEPO's misinterpretation of the court's ruling. PEPO at 37-38.

GCI/City agree with the general premise that when the General Assembly leaves a statutory section unchanged, particularly when the Act is otherwise changed, it is presumed that the legislature knows "the construction the statute has been given and, by

re-enactment, is assumed to have intended for the new statute to have the same effect." Cripes v. Leiter, 184 Ill.2d 185, 703 N.E.2d 100, 106-07, 1998 ILL LEXIS 1570 (1998) (internal quotation marks and citations omitted); see also GCI's Initial Brief on the Impact of HB 2900 at 3. GCI/City disagree, however, with the PEPO's view of the state of the law the General Assembly adopted when it left the terms of section 13-506.1 intact.

The Illinois Bell II decision affirmed the Commission's Alt. Reg. Order approving alternative regulation for IBT under Section 13-506.1 of the Public Utilities Act. 220 ILCS 5/13-506.1. The Commission's 1994 Alt. Reg. Order, as GCI/City have repeatedly pointed out in briefs and testimony, made clear that the Commission believed monitoring earnings was relevant to insuring that shareholder and ratepayer interests were fairly balanced, and that an examination of earnings was an essential part of the review of this first-ever price cap plan, to insure that it was producing a fair, just and reasonable result. See, e.g., 1994 Alt. Reg. Order at 92 ("We also reject Illinois Bell's argument that the adoption of price regulation without earnings sharing eliminates the need for reporting of the financial information identified by Staff" and "unusually high reported rates of return...may constitute a possible early warning that the total offset in the price regulation formula has been set too low or that the pricing constraints have been otherwise ineffective."). The Appellate Court's review of the Alt. Reg. Order never questioned the Commission conclusion that the level of the Company's earnings was relevant to assessing the success of alternative regulation.

The PEPO, however, quotes a portion of the Illinois Bell II decision addressing the constitutionality of Section 13-506.1 of the Act, and concludes that therefore

"earnings do not, and need not, hold the prominence once afforded them under rate of return regulation." PEPO at 146-147. The ALJs rely on this quoted portion of the opinion to bolster their erroneous conclusion that earnings are irrelevant to this review of alternative regulation.

The portion of the Illinois Bell II decision quoted in the PEPO was the Court's response to the limited issue of whether the passage of Section 13-506.1, which permits the Commission to adopt price cap regulation and thereby permit the earning of excess profits, exceeded the state's police power. Illinois Bell II, 669 N.E.2d at 929. The real issue in this review proceeding is not the constitutionality of Section 13-506.1, but how the Commission assesses whether AI's rates are "fair, just and reasonable" as required by section 13-506.1(b)(2) and by Illinois Bell II.

The General Assembly re-enacted section 13-506.1 without modification, thereby leaving the "fair, just and reasonable" standard applicable to alternative regulation. Contrary to the PEPO's conclusion, the definition of that term requires that shareholder and ratepayer interests be balanced. Citizens Utility Board v. ICC, 276 Ill.App.3d 730, 736-737, 658 N.E. 2d 1194, 1200 (1st Dist. 1995). It is impossible to balance ratepayer and shareholder interests without considering the Company's profit level. This would be true whether profits were high or low, and is especially relevant within the context of a proceeding assessing whether revisions are needed to a plan that must produce fair, just and reasonable rates. See 220 ILCS 5/13-506.1(b)(2). Yet, the PEPO suggests that an earnings analysis is not "appropriate." PEPO at 147.

In Illinois Bell II, the Court addressed the question of fair, just and reasonable rates in its decision in response to whether the Commission's presumption that rates set

under the price cap are just and reasonable undermined the fair, just and reasonable standard contained in the Act. The Court confirmed that the just and reasonable standard applicable to public utility rates in general applies to a company under alternative regulation, and confirmed a petitioner's right to challenge the justness and reasonableness of IBT's rates during the pendency of an alternative regulation plan. The Court stated:

> The order does provide that rates filed under the plan 'shall enjoy a presumption that they are just and reasonable, and absent special circumstances, shall become effective without suspension or investigation under [a]rticle 9 of the Act.' We read this language as merely cautioning parties contemplating a rate challenge that the Commission will dispose of frivolous complaints in a summary manner. The ability to bring complaints concerning unjust or discriminatory rates is set forth in the Act. (See ILCS 5/9-250, 10-108, 13-506.1(e) (West 1994).) Administrative agencies, like the Commission, are creatures of statute (Granite City Division of National Steel Co. v. Pollution Control Board (1993), 155 Ill. 2d 149, 171), and thus derive their power from the legislature (Business & Professional People III, 146 Ill. 2d at 195). As such, **the Commission lacks the authority to ignore any portion of its enabling statute.** (See Eckman v. Board of Trustees for the Police Pension Fund (1986), 143 Ill. App. 3d 757, 765.) Therefore, **the Commission may not create an irrebuttable presumption that rates are reasonable and just; neither may the Commission refuse to consider complaints brought pursuant to sections 9-250, 10-108, 13-506.1(e), or any other provision of the Act. To say that rates filed pursuant to the plan are presumed just and reasonable, is merely another way of saying that the petitioner who challenges such rates bears the burden of proof. (See ILCS 5/13-506.1(e) (West 1994).) Anything more would be void as patently beyond the Commission's authority.** See Illinois Power v. Illinois Commerce Comm'n, (1986), 111 Ill. 2d 505, 510 (Illinois Power Co. II).

Illinois Bell II, slip op. at 56-57 (emphasis added). This discussion by the Illinois Bell II Court makes clear that the Court recognized: (1) that an examination of IBT's rates to determine whether they are just and reasonable during a review of the plan is consistent with Section 13-506.1; (2) that upon complaint (such as the CUB/AG complaint in this consolidated docket), the Commission is obligated to determine whether rates are just and reasonable and fairly balance consumer and shareholder interest; and, most significantly,

(3) that the Commission may not create an irrebuttable presumption that rates are fair, just and reasonable. Neither this portion of the Illinois Bell II decision, nor the language cited in the PEPO, stand for the proposition that future examination of the earnings of a company to determine whether rates are just and reasonable in an alternative regulation review proceeding would be inconsistent with Section 13-506.1.

The Illinois Bell II Court did not hold that earnings are irrelevant to setting just and reasonable rates, and the "recent action by the General Assembly" which left that ruling intact, does not support the PEPO's refusal to consider the Company's earnings in assessing whether consumer and shareholder interests are fairly balanced under current rates and under alternative regulation. Nowhere in House Bill 2900 did the General Assembly indicate that the Commission could not or should not reduce rates where it is shown that the Company is receiving profits several times greater than the reasonable cost of capital, and that consumer and shareholder interests are not being fairly balanced. The PEPO's citation of Illinois Bell II as the basis for concluding that earnings are no longer relevant to the examination of the justness and reasonableness of rates under a 13-506.1 plan, is misplaced. The Illinois Bell II decision, and its affirmance of the 1994 Alt. Reg. Order which repeatedly stated that earnings *are* indeed relevant to future examinations of the justness and reasonableness of AI's rates, supports GCI/City's demand for a review of earnings and rate reinitialization.

GCI/City's position, that a review of earnings and rate reinitialization are necessary to balance consumer and shareholder interests, is not based on the assumption or belief that the earning of any excess profit by IBT during the life of the plan is taboo, as GCI City pointed out in its original Brief on Exceptions. See GCI City Brief on

Exceptions at 47. The need for rate reinitialization, rather, is rooted in (1) the record evidence of this case, which shows staggeringly high profit levels for IBT,[1] (2) the 1994 Alt. Reg. Order's unequivocal references to earnings as an important barometer of how well or poorly the approved price cap plan functioned, and (3) the requirement in Section 13-506.1(b)(2) that rates approved under any alternative regulatory plan, including the Commission's first revision of the original plan, at a minimum, be fair, just, and reasonable.

The PEPO also notes that the Court in Illinois Bell II reasoned that the legislature tailored Section 13-506.1 "to secure affordable telecommunications services by use of competitive mechanisms in place of ROR regulation in a manner that attempts to avoid collateral effects unrelated to the legislative objective." PEPO at 147. The ALJs reiterate that the recent reenactment of Section 13-506.1 by the General Assembly presupposes knowledge of judicial decisions such as Illinois Bell II that interpret that law. Here again, however, reliance on this passage is misplaced as a basis for bolstering the argument that earnings are no longer relevant in a price cap paradigm and, consequently, rate reinitialization is not feasible.

The Court's discussion of competitive mechanisms other than ROR regulation falls within that portion of the opinion that addressed the argument that enactment of Section 13-506.1 was beyond the state's police power. The plain language of the statute obviously permits the adoption of non-traditional regulatory mechanisms intended "to secure affordable telecommunications services by using competitive mechanisms in place

[1] As pointed out elsewhere, GCI/City calculated a return on equity of 43% and Staff and the Company calculated returns on equity of 40.1% and 24.5%. GCI/City Ex. 6.2 at 5; Staff Ex. 30.0, 30.01; AT Ex. 7.3. The market required return on equity range calculated by Staff and the Company are significantly

of ROR regulation." Illinois Bell II, 669 N.E.2d at 930. This fact is not in dispute. However, the Court's affirmation of the adoption of such regulatory mechanisms in no way prohibits the Commission from examining IBT's earnings within the record of this alternative regulation review proceeding to fairly balance consumer and shareholder interests to determine if the rate levels established under the plan are just and reasonable today, and on a going-forward basis in a future revised plan.

The 1994 Alt. Reg. Order assumed that the price index and market forces would act to limit high, monopoly earnings. 1994Alt. Reg. Order at 187. As noted in GCI/City's Exceptions at pages 15-17 and 47-52, this phenomenon did not occur. Significant competition for the residential local service market has not materialized in the past six years.[2] The balance between ratepayer and investor interests that the Commission sought to carefully frame in its 1994 Alt Reg. Order has tilted significantly in favor of AI shareholders. See, e.g., 1994 Alt. Reg. Order at 19. As such, establishing a revised alternative regulatory plan necessarily requires (1) a recognition that the going-forward rates are being established for what must still be described as a monopoly local service market, and (2) given the absence of competition, the use of a traditional earnings analysis to evaluate whether the rates set under the price cap plan are, in fact, fair, just and reasonable. The recent reenactment of Section 13-506.1 and the Commission's original 1994 Alt. Reg. Order, upheld by the Second District Appellate Court in Illinois Bell II, demand no less.

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lower, at only 11.80-14.40%% and 11.86-12.71% market based return on equity, respectively. Staff Ex. 11; AI Ex. 6.

[2] The record showed that as of 1999, IBT retained 95% of the total local service market. Because a substantially higher percentage of the business market is competitive, it is likely that considerably more than 95% of the residential market is served by IBT. City Ex. 1 at 25.

Finally, it should be noted that the ALJs assertion that the final order in this docket will not produce a *new* plan is a cornerstone to their refusal to consider rate reinitialization and an examination of earnings. PEPO at 146. These semantics do not change the fact that this Order will produce a *revised* plan, a fact recognized by the Commission itself when discussing the parameters of this review proceeding. See 1994 Alt. Reg.Order at 51 ("The Commission will, in its future review proceedings, entertain evidence and argument of policy considerations for the provision of some forms of earnings sharing in a *revised* plan.") The fact remains that Section 13-506.1, the 1994 Alt. Reg. Order and the Appellate Court's interpretation of that Order in Illinois Bell II require that *any* plan – not just the initial one – must produce fair, just and reasonable rates. Unless rates in this docket are reinitialized, that statutory and policy directive will not be met.

B. The Legislative Reclassification, Refund And Fixed Rate Package Obligations Do Not Indicate A Legislative Intent To Exclude Consideration Of Earnings In Assessing Whether The Alternative Regulation Plan Has Produced Fair, Just And Reasonable Rates.

The PEPO refers to three new sections of the Act, sections 13-502.5, 13-518 and 13-101, which it claims further support its view that earnings are irrelevant to an assessment of alternative regulation and whether rates are fair, just and reasonable. These sections do not support the PEPO's conclusions.

First, the PEPO refers to section 13-502.5, which addresses the reclassification of business and vertical services from non-competitive to competitive status. It finds "valid" Staff's observation that "rates are being set with no mention of earnings but with an exclusive and direct focus on price." PEPO at 150. Staff and the PEPO are trying to unreasonably read into the language of the statute an intent that truly is not there. The

language of section 13-502.5 directs that services to business end users be classified as competitive, and that:

> Rates for retail telecommunications services provided to business end users with 4 or fewer access lines shall not exceed the rates the carrier charged for those services on May 1, 2001. ...provided, however, that nothing in this Section shall be construed to prohibit reduction in those rates.

220 ILCS 5/13-502.5(b). The rates subject to this provision were not "set" by the General Assembly, as Staff and the PEPO would suggest. PEPO at 150. Rather, the rates were capped at their current levels. The General Assembly did not engage in rate-setting, and it is unreasonable and irrelevant to suggest that the General Assembly did not mention earnings when it capped but otherwise did not modify these rates. It would have had no need to mention earnings, as it did not address the Company's overall rate structure and is not a rate-setting body. This rate cap is clearly a protection to small business consumers in an interim period, and limits the Company's freedom to increase both rates and revenues in connection with those consumers.

In section 13-502.5(d) the General Assembly directed the Company to refund $90 million to customers who were alleged to have paid rates in excess of noncompetitive rates. Staff and the PEPO again suggest that this lacks reference to earnings, and so supports their view that the Commission should not examine the Company's earnings in this alternative regulation review docket. First, the law does not say on what the $90 million refund is based. It could be based on revenues, earnings, data from Docket 98-0860, or other undetermined factors.

Second, there is an additional $30 million payment specified in section 13-502.5(e), which does not reference rates, revenues, or any other bases. This does not

evidence or even imply an intent to abandon all review of Company revenues. Third, the refund and additional $30 million contribution are for set amounts, which will plainly affect the Company's revenues. If the General Assembly's actions were "exclusively and directly focused on price", rather than on revenue or a simple "deal," the refund and the contributions would have been stated as a price reduction, not a total revenue amount.

Section 13-502.5 has no bearing whatsoever on the question of whether earnings should be considered in evaluating alternative regulation and in determining whether the Company's rates are just and reasonable and fairly balance consumer and shareholder interests. Moreover, neither Staff nor the PEPO acknowledge that the General Assembly continues to require cost studies in setting competitive rates pursuant to section 13-502(c). Clearly, the cost basis for competitive services has not been wholly eliminated, as Staff and the PEPO imply.

The PEPO further attempts to use section 13-518, which requires the Company to offer optional, fixed rate service packages, to bolster its position that the General Assembly somehow addressed whether earnings were relevant in this alternative regulation review. PEPO at 150. Section 13-518 does not address that issue implicitly or explicitly. The fact that the Company is now required to offer a fixed monthly charge for certain packages is not an endorsement of price regulation. On the contrary, the requirements that the packages "result in savings for the average consumer" and that the rates be reviewed "pursuant to Article IX of [the PUA] to determine whether such rates, terms, and conditions are fair, just, and reasonable" demonstrate that the General Assembly expects that traditional ratemaking analyses, which undoubtedly include an

earnings and profit analysis, will form the basis of the rates set for these fixed rate packages. See 220 ILCS 5/13-518(a).

The PEPO further rejects GCI's reference to the language added to section 13-101, which provides that a carrier's rules and regulations affecting competitive services must be just and reasonable.[3] GCI maintain that this amendment demonstrates that the General Assembly did not intend to abandon the just and reasonable standard in connection with competitive services, but in fact expanded it to include all rules and regulations regarding competitive rates and services. Contrary to the PEPO's comments, GCI never argued that this provision applied uniquely to Ameritech. PEPO at 150. GCI simply pointed out that the General Assembly expanded the regulatory review implicit in the just and reasonable standard to competitive services, thereby showing that even competitive services are not immune from regulatory oversight and cost of service principles. See GCI Initial Brief on the Impact of HB 2900 at 3-4.

Finally, the new section 13-712, which addresses service quality, explicitly directs the Commission to consider carriers' "gross annual intrastate revenue" in determining service quality rules and penalties. 220 ILCS 5/13-712(c). Similarly, Section 9-230, which was also amended in HB 2900, refers to including directory revenues in ascertaining a company's rate of return, and specifically includes those revenues in "determining a reasonable rate of return." Clearly this section refers to telephone

[3] The amendment reads: "In addition, as to competitive telecommunications rates and services, and the regulation thereof, all rules and regulations made by a telecommunications carrier affecting or pertaining to its charges or service to the public shall be just and reasonable, provided that nothing in this Section shall be construed to prevent a telecommunications carrier from accepting payment electronically or by the use of a customer-preferred financially accredited credit or debit methodology. As of the effective date of this amendatory Act of the 92nd General Assembly, Sections 4-202, 4-203, and 5-202 of this Act shall cease to apply to telecommunications rates and services." The PEPO chastises GCI for taking the first sentence, which ends before the word "provided", out of context. GCI/City point out that the only relevant portion

companies, and directs that directory revenues be included until May 31, 2003. As IBT has litigated this issue repeatedly before the Commission, the General Assembly's comment on it demonstrates a legislative intent that revenues continue to be the subject of regulatory scrutiny. See GCI Initial Brief on Impact of HB 2900 at 1-2. These sections reveal that the General Assembly has not abandoned the notion that a company's revenues are relevant to whether its rates and terms and conditions are fair, just and reasonable. There is nothing in sections 13-502.5 or 13-518 to the contrary.

C. Conclusion

The PEPO erroneously uses the Illinois Bell II decision and recent amendments to the Act to bolster its failure to review the Company's earnings to evaluate whether existing rates under the price cap plan are just and reasonable and fairly balance consumer and shareholder interests. By failing to consider the Company's unreasonably high profit level, the PEPO has utterly failed to conduct a meaningful assessment of IBT's rates and whether the alternative regulation plan struck a fair balance between consumers and shareholders. As the Court in Illinois Bell II pointed out, section 13-506.1(b)(2) requires that rates be reviewed under the fair, just and reasonable standard, and prohibits an irrebuttable presumption that price cap rates are just and reasonable. The PEPO disregards these requirements, and should be modified.

Proposed Language

The Notice of ALJ Ruling accompanying the PEPO limits the parties to discussing matters that were affected by the HB 2900 amendments to the PUA. Therefore, the changes that must be made to the section, Has the Plan Produced Fair, Just

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of the amendment is the first portion which addresses just and reasonable requirement to rules and regulations concerning competitive rates and services. See PEPO at 150.

and Reasonable Rates, pages 25-39, to make that section correspond with the law as discussed above will not be restated. However, they can be found at pages 20-32 and 101-102 of the GCI/City Exceptions.

The PEPO addresses the effect of HB 2900 directly starting at page 139. GCI/City recommend the following changes to the Commission conclusions starting on page 146, in the Commission Analysis and Conclusion section.

~~We cannot help but note that the GCI assertions for an earnings review and corresponding rate reinitialization in this instance were foreshadowed by the arguments that were presented to the Court in its review of the Alt Reg Order, to wit:~~

> ~~CUB assets, without support, that the original purpose of the Act was to protect 'the public from public utilities charging rates that produce excess profits.' CUB argues that Section 13-506.1 'subverts' this original purpose. Illinois Bell Telephone Company v. Illinois Commerce Commission, 283 Ill.App.3d 188 at 202, 669 N.E. 2d 919 (2d Dist.1996).~~

~~In response thereto, the Court reasoned that:~~

> ~~Assuming arguendo that CUB is correct about the purpose of the Act and its "subversion' by Section 13-506.1, this does not render Section 13-506.1 beyond the state's police power... The police power provides the authority to legislate for the public good; it does not specifically define the public good or the manner in which the legislature should act pursuant to its police power. The police power, therefore, does not mandate legislation to prevent excess profits. Even if the [Public Utilities] Act's purpose were to prevent excess profits, this would not require all subsequent regulation of public utilities to share this purpose. (Id.). (emphasis added).~~

~~With this pronouncement, the Court made clear that under alternative regulation pursuant to Section 13-506.1, earnings do not, and need not, hold the prominence once afforded them under rate of return regulation. Still further, the Court reasoned that the legislature carefully adopted and tailored Section 13-506.1 to secure affordable telecommunications services by use of competitive mechanisms in place of ROR regulation in a manner that attempts to avoid collateral effects unrelated to the legislative objective. (Id.)~~

The GCI/City are ~~is~~ indeed correct ~~in asserting~~ that in determining legislative intent, it is presumed that the legislature acted with knowledge of judicial decisions concerning prior and existing law. This is a well-settled doctrine and wholly applicable to the instant setting. In OSF Healthcare Systems v. County of Lee, 607 N. E. 2d 699, 702 (2nd Dist. 1993), the court recognized that, by its reenactment of a prior statute, the legislature is presumed to have intended to adopt any clearly established judicial interpretation of that prior legislation. In light of the recent reenactment of Section 13-506.1 in its original form and the long-standing interpretation thereof outlined by the Court (which preceded such action), we find that in order to assess whether AI's rates comply with the statutory mandate that they remain fair,just and reasonable under alternative regulation, we must carefully balance consumer and shareholder interests. We can only conduct this balancing test by reviewing AI's revenue and expense level during the course of the price cap plan. In determining whether rates going forward would be fair, just and reasonable, we must compare those earnings with the reasonable cost of capital, and adjust rates accordingly. Failure to conduct this analysis would sanction a windfall to the Company, which was not our intent when we adopted alternative regulation for AI. ~~there is no basis for believing that an earnings analysis and reinitializing rates thereon is here appropriate.~~

To be sure, e~~E~~arnings under alternative regulation are the function of a completely different set of ~~initiatives~~ incentives than earnings generated under traditional regulation and must be viewed in that context. An increase in earnings was not unexpected just as a reduction in rates was expected. Nevertheless, in this review of the alternative regulation plan, we have found that the price index did not capture a fair portion of savings for consumers. The high earnings during the course of the plan are not subject to change, but going forward, we have an obligation to reset rates to fair and reasonable levels. The Company retains the incentives to better its performance, but from a starting point where consumer and shareholder interests are balanced. ~~In a period of high overall prosperity, as was the situation in the Plan's initial term, that expectation level only increased. Given all of the coming changes in the telecommunications marketplace and the variations in the economic climate, however, we do not see AI being able to manage either costs or earnings nearly as effectively in the next term.~~

The reinitialization of rates is a necessary part of this review of alternative regulation. Without the authority to reinitialize or change rates, this review would be a meaningless exercise, and the rate level based on a 1992 test year, almost 10 years ago, would determine rates forever going forward. This was not our intent in 1994, and we will not be so limited in this proceeding. Although price regulation focuses on prices rather than earnings, in order to assess whether the price index has been successful in balancing consumer and shareholder interests, we must consider the level of Company earnings, as this represents the extent to which rates exceed cost, including the cost of capital. ~~very much a form of ROR regulation. As such, it is inconsistent with the principle of alternative regulation which puts the focus on prices and not on earnings. As Staff and AI observe and the evidence shows, reinitialization carries the potential for a~~

~~number of material and far-reaching consequences.~~

~~In this instance, the reinitialization proposal would effectively stop the Plan, rewind it under ROR regulation, and then run the Plan again. The irrationality of such a scenario is obvious. On the basis of our review thusfar, we are inclined to we reject the proposal.~~ We will review ~~view~~ the CUB/AG complaint, which is based on these same underlying assertions, ~~to also fail.~~ according to the same principles applicable to our review of the rates created by alternative regulation, pursuant to section 13-506.1 of the Act.

Our analysis, however, continues as we review and consider in more detail, the new statutory changes which are mentioned in the parties' arguments. In doing so, the Commission is mindful of the fact that Section 13-506.1 has not been changed under the recent legislative initiative. Other provisions, however, were enacted which are expressly and specifically directed to telecommunications carriers operating under Section 13-506.1, alternative regulation. We are compelled to consider these new directives even as we proceed pursuant to Section 13-506.1 in this matter. It is a well-settled principle that a court determines the legislature's intent by examining the entire statute and by construing each material part or section of legislation together, and not each part or section alone. Mc Namee v. Federated Equipment and Supply Co., Inc., 692 N.E. 2d 1157 (1998); Henrich v. Libertyville High School, 712 N.E. 2d 298 (1998). Hence, we will consider the just and reasonable rate pronouncement of Section 13-506.1 in relation to all of the relevant provisions that were recently enacted as both the law directs, and as the parties would have us do.

I. Section 13-502.5 Services alleged to be improperly classified

~~At the start, Section 13-502.5 (a), abates all actions or pending Commission proceedings wherein it is alleged that a telecommunications carrier has improperly classified services as competitive.~~

As it pertains to Ameritech, (a telecommunications carrier subject to an alternative regulation plan under Section 13-506.1 as of May 1, 2001) Section 13-502.5 (b), i.e., mandates that all retail telecommunications services provided to business end users shall be immediately classified as competitive with no further Commission review.

Under this same provision, the statute directs that rates for retail telecommunications services provided to business end users with 4 or fewer access lines, are not to exceed the rates charged as of May 1, 2001, and further mandates that this restriction continue in force through to July 1, 2005. 220 ILCS 5/13-502.5 (b).

Pursuant to Section 13-502.5 (c), and again as it pertains to Al (a telecommunications carrier subject to an alternative regulation plan as of May 1, 2001), all retail vertical services, except caller identification and call waiting, are to be classified as competitive on June 1, 2003 with no further Commission review.

Near its end, Section 13-502.5 (d) proscribes that as resolution for any action or proceeding, now abated, wherein it is alleged that a telecommunications carrier has improperly classified services as competitive, the carrier subject to such action or proceeding is liable to and shall refund $90 million to that class or classes of its customers that were alleged to have paid rates in excess of noncompetitive rates as a result of the alleged improper classifications. Further, those services, the classification of which is at issue, are now deemed competitive or noncompetitive as per the provisions of this Section, i.e., 13-502.5.

II. Section 13-518, Optional service packages

In Section 13-518, the General Assembly has expressed its intent to have available, unlimited local service packages at prices that will result in savings for the average customer. Given that Al provides competitive and noncompetitive services (and is subject to an alternative regulation plan under Section 13-506.1), it is required to provide, in addition to other services that it offers, certain "optional packages of services" described in this provision, for a fixed monthly rate which the Commission shall review under Article IX of the Act to determine if the rates, terms, and conditions, of the packages are fair just and reasonable. (This Commission review has not been made a part of the instant proceeding).

Section 13-101. Application of Act to telecommunications rates and services.

Finally, the amendatory language to Section 13-101 provides that with respect to competitive rates and services, and the regulation thereof:

> All rules and regulations made by a telecommunications carrier affecting or pertaining to its charges or service to the public shall be just and reasonable, provided that nothing in this Section shall be construed to prevent a telecommunications carrier from accepting payment electronically or by the use of a customer-preferred financially accredited credit or debit methodology. As of the effective date of this amendatory Act...Sections 4-202, 4- 203, and 5-202 of this Act shall cease to apply to telecommunications rates and services. 220 ILCS 5/13-101.

We disagree with Staff that the recent amendments to the Act bear significantly on, and must be factored in, any final resolution of the instant issue. Indeed, it is well established that a court must decide litigation in accordance with the law in force, at the time of its decision. Sagittarius, Inc., v Village of Arlington Heights. (1st Dist. 1980). Even a reviewing court must dispose of a case under the law in effect when its decision is rendered. Premier Property Management Inc. v. Chavez, 728 N.E. 2d 476 (2000).

The "without further Commission review" language contained in Section 13-502.5 precludes Commission action in this or any other proceeding as to the measures prescribed. 220 ILCS 5/13-502 (b);(c). Thus at this point in time and pursuant to the General Assembly's mandate, all retail business communications services are classified as competitive. Further the rates for such services being provided to business end customers with 4 or fewer access lines are set, by statute, at the rates in place on May 1,2001 and are required to remain so until June 1, 2005.

Under the provisions of Section 13- 502.5, which directly implicate AI, rates are capped ~~are being imposed~~ by statute ~~both outside the Plan yet with full and express knowledge that AI is subject to the Plan~~. We note that the legislature did not set any rates, although it did give the Company the option to decrease rates for certain business customers. Further, we reject Staff's notion that the lack of a reference to the Company's earnings in this section somehow shows that in this alternative regulation review docket we need not consider the Company's earnings. We would not expect the legislature to directly address a specific Company's earnings in a statute. Further, we disagree with Staff's argument that the legislature set rates "with an exclusive and direct focus on price." The legislature capped rates, just as it did in section 13-506.1(c). That does not show a preference for price regulation. ~~the validity of Staff's observation that rates are being set with no mention of earnings but with an exclusive and direct focus on price.~~

So too, as Staff notes, AI falls under the criteria of Section 13-502.5 such that it is required to refund $90 million to consumers of business services that may have been prematurely classified as competitive. We note that this refund obligation, which did not set any rate or reference any specific price, will surely reduce the Company's revenues, contradicting the notion that the legislature "exclusively and directly" focused on price. Further, we note that the Company is obligated to pay another $30 million into various funds pursuant to section 13-502.5(e). These obligations would not have been enacted had the General Assembly not believed that the Company had sufficient revenues to cover these obligations. ~~This action, however, is not proscribed on the basis of, or with any reference whatsoever, to the Company's earnings. As AI effectively asserts, any further reductions in rates would be inconsistent with the intentions of the General Assembly as clearly reflected in the statute.~~

With respect to the General Assembly's concern for the average customer, AI is required to provide certain "optional packages of services" for a "fixed monthly rate" in addition to any other services it offers. These packages are to result in savings for the average customer, and to be treated as noncompetitive, despite the fact that they may contain services classified as competitive. The Commission is left to determine if the particular rate, terms and services are fair, just and reasonable under Article IX. We find that including these packages in alternative regulation, as discussed in connection with the basket structure, will insure that they are set at fair, just and reasonable levels, consistent with other non-competitive rates. ~~Here too, the General Assembly has~~

~~required action outside the Plan and not under the provisions of Section 13-506.1.~~

To be sure, the "just and reasonable" pronouncement in Section 13-101, which the GCI emphasize, demonstrates that even with regard to services classified as competitve, the legislature intended that consumers be treated fairly. ~~has been taken out of context and misapplied by their abbreviated account. A fair and complete reading of~~ The amendatory language shows that it is the rules and regulations of each and every telecommunications carrier which are now subject to this standard. We note that the legislature used the same language to regulate competitive services that is traditionally used for noncompetitive, monopoly services. If it did not intend the same definition of just and reasonable that has developed over the years in judicial opinions and Commission actions, see, e.g., Citizens Utility Board v. ICC, 276 Ill.App.3d 730, 736-737 (1st Dist. 1995), it could have used a different term in authorizing Commission regulatory oversight. ~~As AI argued, Section 13-101 does not uniquely apply to Ameritech nor does it bear on the proper interpretation to be given Section 13-506.1. We fully agree.~~

In the final analysis, an earnings review and a reinitialization such as argued for by the GCI, is fully consistent ~~cannot be squared~~ with the recent classification, credit and rate- setting actions and optional service package directives of the General Assembly. Further, as we have already noted, the General Assembly reenacted Section 13-506.1 after the courts concluded that although preventing excess profits, is not and need not be, the purpose of alternative regulation under Section 13-506.1, rates must be affordable, and affordability is determined by the "fair, just and reasonable" standard found in Section 13-506.1(b)(2). This term has been the subject of close to one hundred years of regulatory history and has become a term of art meaning that consumer and shareholder interests are fairly balanced so that consumers pay no more than is necessary, and shareholders receive no less than is reasonable. All total, a reinitialization of rates on the basis of earnings and on the record developed in this proceeding, is consistent ~~cannot be reconciled~~ with the recent legislative initiative, with Section 13-506.1, and is necessary to fulfill our obligation to require that alternative regulation produce fair, just and reasonable rates.

~~These are the additional grounds, which sustain our rejection of the GCI/City proposal to reinitialize rates.~~

II. INCONSISTENT WITH THE PURPOSE OF THE BASKET THE BASKET STRUCTURE PROPOSED BY THE PEPO IS STRUCTURE AND MIS-INTERPRETS THE EFFECT OF THE NEW STATUTORY PACKAGES.

The PEPO modifies the basket structure to assign the new statutory packages mandated by section 13-518 and other packaged rates to the Residential and Other baskets, respectively. The assignment of packages recommended in the PEPO should be rejected as inconsistent with the purpose of the basket structure and as undermining the limited protections the price index currently affords consumers.

In order to understand the problems with the PEPO's assignment of the packages to baskets, it is useful to keep the purpose of the baskets clearly in mind. First, the baskets were created to insure that each customer class benefitted from the price index (i.e. that price decreases were spread among all customer classes). The second objective, met by establishing the "Residential" and the "Other" basket, is relevant to the residential customer class only. The Commission expressly intended to insure that the price index would be applied to the most basic and inelastic residential services, i.e. network access and usage. By isolating those services in Residential basket, the Commission insured that price decreases required by the price index would inure to the benefit of low use, inelastic consumers. This protects the most basic, inelastic services from being the repository of rate increases, while the rates of more elastic services are decreased. 1994 Alt. Reg.

Order at 69-71[2]. The PEPO's treatment of the baskets should be reviewed in light of these objectives.

The PEPO would assign the new statutory baskets to the Residential basket, purportedly to avoid fragmenting network access between two baskets. PEPO at 107. Specifically, the PEPO says: "To divide residential network access between to [sic] baskets, would only serve to weaken or dilute its position within each basket." GCI/City agrees that it is important not to "weaken or dilute" the protections the current basket structure affords network access. However, adding services to the Residential basket, particularly the statutory packages, if they include access, usage, second lines, local toll calling and vertical services in a bundled rate, will have precisely this effect. If the Residential basket were expanded to include packages that combine several services (some with high margins, some with low margins, some discretionary and some essential and inelastic) into one price, the Company would have more opportunities to avoid reducing unbundled residential access and usage under the price index because the price changes could be spread over a larger number of packaged or bundled services. The PEPO correctly identifies the problem to be solved, but errs in its resolution by not keeping unbundled residential network access and usage in their own basket.

The PEPO rejects GCI/City's proposal to create a separate Statutory basket for the section 13-518 packages because, it asserts, all of the packages contain network

[2] An example of the Commission's rationale is: "This pricing flexibility feature creates the possibility that the Company could raise prices on those services for which it faces inelastic demand while decreasing prices for services for which if faces elastic demand. ... The Commission believes that unlimited pricing flexibility of services provided to customers with little or no alternative choices is contrary to the goals of the General Assembly in legislating the opportunity for an alternative regulatory plan. ..." 1994 Alt. Reg. Order at 70.

access, and it would "fragment" network access to have it in two baskets. PEPO at 107. The PEPO's reasoning and conclusions are erroneous and are contradicted by the actual structure of the one statutory package that the Commission has already approved.

Under the statute, the prices for statutory packages are to be "a fixed monthly rate". 220 ILCS 13-518(a). Therefore, if a single, fixed rate is set for each package, neither the consumer nor the Commission could distinguish the access price from the usage, vertical services, second line or local toll price, as they would all be bundled in a single, fixed monthly price. The network access line rate would not be fragmented because there would still be only one unbundled, network access line price in the Residential basket.

The Company's "budget package", which has already been approved by the Commission, includes a fixed charge of $12.50 for unlimited Band A and B usage, but the network access line charge is the existing charge, depending upon whether the consumer is in access area A, B or C.[3] The "package" does not change the network access line charge, and the access charge and the usage charge are not commingled. In effect, the budget statutory package is no different from SimpliFive or CallPak in that consumers pay their existing access charge, and only their usage charge varies from basic rates. The distinctions the PEPO attempts to make between the statutory package and the SimpliFive and CallPak rates are illusory. The PEPO says: "Voluntary plans may bundle network access with usage or they [may] not. However, the mandated packages may not

[3] GCI/City request that the Commission take administrative notice of the tariffs filed by IBT on July 20, 2001, which IBT identified as establishing "a new optional calling plan which gives subscribers unlimited Bands A and B usage for a flat monthly rate." The tariffs and transmittal letter are attached as Exhibit B. Administrative notice is requested pursuant to 83 Ill.Adm.Code 200.640(a)(3).

be offered without offering network access." PEPO at 106. This statement is plainly incorrect. The statutory budget plan already approved offers a set price for unlimited usage. It does not offer access on terms different from basic rates. Therefore, the structure of the "budget" statutory package does not affect network access line rates.

If these packages were added to the Residential basket, where access is broken out as a separate charge matching basic rates per access area, the price index protections the Commission carved out for the most inelastic services will be diluted by the addition of packages that in the future will contain substantially more than access and usage. See Section 13-518(a)(2)("flat rate package with two vertical services); (3)("enhanced flat rate package" with two vertical services, two lines and unlimited local toll). It would be more consistent with the purpose of the basket structure to leave the access charge in the Residential basket when it is not bundled into the packaged rate. If the network access line charge and usage or other services are combined into a single, fixed rate, the combined rate should be placed in a separate basket.

Further complicating consumer protections and understanding, the PEPO would treat the statutory packages differently from other "discretionary" packages. The three statutory packages, which are to contain: (1) access and unlimited local calls, (2) access and unlimited local calls and the customer's choice of 2 vertical services, and (3) two lines, access and unlimited local and toll calls, and the customer's choice of 2 vertical services[4], are to be in the Residential basket, while other packages, such as SimpliFive,

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[4] Two of the three statutory packages include services that are currently in the residence and other baskets, and after June 1, 2003, these packages can contain services that are competitive and non-competitive as well. See section 13-518(a) and 13-502.2(c).

CallPak, and presumably the "Solution" packages passed to file on October 2, 2001[5], would be assigned to the "Other" basket because they are discretionary. This is internally inconsistent, undermines the efficacy of the basket structure, and is harmful to consumers.

In Reply Exceptions and in briefs in response to HB 2900, GCI/City argued that the residential statutory packages should be placed in their own "Statutory" basket. GCI/City Reply Exc. at 10-12; GCI Initial Brief on Impact of HB 2900 at 10-11. In light of the PEPO's rejection of GCI/City and Staff's recommendation to put plans like SimpliFive and CallPak in the Residential basket, where the underlying services (access and usage) are found, GCI/City maintain that a separate basket for all packages would best protect consumers of basic service. This is particularly true for low volume users because their basic rates will be unaffected by packages that are directed to consumers who want unlimited use. Indeed, the first package offered by the Company, is priced at $12.50 for unlimited Band A and B usage only (access is priced separately). This equals 250 peak, band A calls per month, or more than 8 peak calls per day, and would not benefit consumers who make 1-2 calls per day unless they are long duration band B calls. If this package were placed in the residential basket, prices for usage or access could be increased, while the package price is decreased under the price index. The package, however, will remain uneconomic for the small user, and the small user will see

[5] A copy of the tariffs for these services is attached as Exhibit C. . Administrative notice is requested pursuant to 83 Ill.Adm.Code 200.640(a)(3).

prices for basic service – access and usage – increase despite the fact that costs are declining.[6]

The PEPO does not accurately present GCI's arguments in favor of putting the packages in a separate basket. The PEPO says:

> "GCI/City argue that by placing the mandated plans within their own basket, the Company will have no ability to manipulate their prices. GCI/City suggest that unless the mandated plans are removed from the Residential basket and placed within their own basket, the Company could raise the prices of the mandated plans and offset those increases with decreases to high margin services contained within the same basket."

PEPO at 107. A more accurate depiction of GCI/City's position is that (1) if the packages are assigned to the Other basket, the Company could increase package prices while decreasing the prices of high margin, highly elastic services, but (2) if the packages are put in the Residential basket, the Company could lower the package prices (which are aimed at high volume users) while increasing unbundled network access lines rates, thus increasing the most inelastic, core service rate, to the detriment of low volume users. The PEPO inverted GCI/City's arguments by representing the concern that the prices of the packages may be increased in the Residential basket, when the real concern is that the package prices will be decreased and basic, unbundled prices increased, thereby driving consumers to subscribe to an otherwise uneconomic package. See PEPO at 106.

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[6] IBT continually asserts that residential access is priced below cost, although the cost study on which it relies has been rejected by Staff and corrected by GCI witness William Dunkel to the extent that a $1.30 **reduction** in the residential network access charge is necessary to accurately reflect cost. Further, IBT has repeatedly stated its intention to make no reductions to the residential network access line charge. Putting the statutory packages in the same basket as the residential NAL will provide the Company with the opportunity to increase the residential NAL while it decreases the more discretionary package rate.

The PEPO concludes that SimpliFive and CallPak have been properly treated as "new services" and properly assigned to the "other" basket. It further concludes that: "Given the new ability to choose a statutorily mandated calling plan the significance or impact of the two voluntarily offered plans described above on either the Residential or Other basket will undoubtedly be diminished." PEPO at 106. The PEPO is wrong to treat calling plans like SimpliFive and CallPak as new services when they merely reprice existing services, and even more wrong to conclude that the impact of this approach is diminishing due to the new statutory packages.

GCI will not reargue why existing services that are repriced should not be treated as new services and set at prices without regard to the price index. See, e.g., GCI/City Brief on Exceptions at 39-40; AG Initial Brief at 63-64. However, the notion that such repriced service packages will be of diminishing significance in light of the statutory packages has been disproved as recently as September 25 and October 2, when the Commission passed to file TRM # 781, 782, 783 and 810, Ameritech Illinois' "Economy Solution", "Sensible Solution" and "Complete Solution" packages. See Exhibit C attached hereto. Clearly, packaged services are not diminishing in significance, and so long as prices for plans or packages that include essential services can be set without regard to the price index or the basket structure, the protections afforded consumers by alternative regulation will themselves diminish.

The PEPO recognizes that the packaged services often contain services traditionally found in more than one basket and may even include competitive services. PEPO at 106. The proposed solution, to put the statutory packages in the Residential basket and put the other packages in the Other basket as "discretionary" services, see

PEPO at 104, does not conform to the Commission's goal to reserve some of the benefits of the price index for consumers of simple network access and usage. Further, the PEPO's stated concern about fragmenting services among several baskets is similarly not advanced by this structure, which artificially differentiates the statutory packages from other packages. A more rational and consistent approach would be to put all packaged or bundled services in a separate basket, so that consumers of the non-competitive services in those baskets receive the protections of the price index to the same extent that consumers of the Residence services of simple access and usage, and consumers of Other services receive the protections of the price index.

GCI/City maintain that the reasons for subjecting packages that reprice existing services to the price index, rather than pricing them as "new services" unconstrained by the price index, is even more compelling with the advent of the statutory baskets. Consumers will need more protection, not less protection, because they will likely be barraged by offers and advertisements for packages of basic, non-competitive, services without adequate price disclosure. Consumers rely on the Commission to insure that they pay a reasonable and affordable price for basic telecommunications services, and in the absence of an earnings review (which GCI supports, but the PEPO rejects), the price index is the Commission's only remaining tool under alternative regulation to maintain reasonable telephone rates and promote affordable and universal service.

If packaging of access and usage together, or repricing usage in a bundle or flat rate, removes these basic services from the price cap, a gaping hole in the price index protections and limitations will be created. The prices for access and usage, when packaged together or with other services, could be raised without serious competitive

pressure (the record shows IBT retains 95% of the business and residential local service market. City Ex. 1.0 at 25.) and without regulatory restraint. They can then be slowly reduced while unbundled access rates are increased. For consumers, this is the worst of both worlds.

In summary, PEPO's basket recommendations would doubly harm consumers: First, the packages or plans are treated as "new services" and so their prices are set without regard to the price index (even if access and usage are the only services included). Without price cap constraints, the price for the packages can be set above the level allowed by the price index. Second, the new price is imported into the Residential basket, and can be lowered from an originally unconstrained level in order to justify increases in the network access line charge or basic usage.

The packages were intended to result in cost savings to average consumers. The General Assembly did not intend that they provide the vehicle for increasing the residential NAL and basic usage, which are the most inelastic and essential services. The combination of treating packages and plans as new services and placing the packages in the Residential basket will lead to this unjust and unintended result.

GCI/City propose that the pages 104 through 107 be amended as follows. New language is both underlined and italized.

Commission Analysis and Conclusion

The Commission concludes that the current ~~four basket~~ four-basket structure is no longer viable ~~should be continued~~ on a going forward basis. With the passage of HB 2900, the make-up of the current basket system requires some modification. AI's arguments for a modification from a four-basket system to a single basket system are not persuasive. ~~Since the opening of Docket 98-0860, AI returned all the residential services which were previously reclassified as competitive to a non competitive status. Serious questions have been raised as to the propriety of the business services AI reclassified as competitive. Under the Plan, provisions were made allowing for services to be returned~~

~~to a noncompetitive status as well as new services being added to baskets.~~ The elimination or consolidation as proposed by AI does not further the goals of protecting consumers ~~a customer class~~ against cross subsidies. The Commission finds that a ~~four~~ multiple basket structure ~~continues~~ will ~~to~~ ensure that all customer classes are treated equitably, free from discrimination and cross subsidies. We conclude that a *modified four* ~~three~~-basket system *for residential services* is appropriate on a going forward basis. The baskets are Residence, Other, *Packages* and Carrier. The contents of each basket will remain as they have been, except as provided for below.

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We further conclude that AI has *not* properly treated voluntary residential calling plans (SimpliFive and CallPak), *and that they should not be treated* as new services. *Services that are the same as existing services, such as usage, should be priced consistent with the price index and placed in the basket of the existing service, unless the service is bundled with another service and the prices for each service cannot be determined from the bundled service or plan.* ~~and has properly assigned them to the "Other" basket. These particular calling plans are optional to the customer and are provided by the company on a voluntary basis. A customer is not required to enter into a calling plan before usage may begin and therefore a customer's decision whether to enter into a calling plan is discretionary. A customer may refrain from obtaining the voluntary plans and remain simply with residential access plus basic service, or obtain one of the mandate packages.~~ The mechanisms currently in place for new services and how they are to be treated within the PCI shall remain on a going forward basis *but only be applicable to packaged or bundled services for which the individual services are not separately priced.* Given the new ability to choose a statutorily mandated calling plan *and the growing prevalence of packages and plan,* the significance or impact of ~~the two~~ voluntarily offered plans described above on either the Residential or Other basket will undoubtedly *grow.* ~~be diminished.~~

Therefore, we will create a new packages basket, to hold all service packages that contain more than one service. This will preserve price cap benefits for simple, unbundled service, which would be lost if packages were placed in the same basket as, for example, usage and access.

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The Commission ~~is now presented with the task of~~ determin*ges that the statutory packages, as well as other bundled packages or plans, should be placed in their own basket.* ~~which, if any, of the existing baskets would be an appropriate location for the statutorily mandated calling plans found in 13-518(a)(1)-(3) of the Act.~~ As noted above by the parties, taken as a whole, the three mandated plans contain services traditionally found in two baskets and some services that are outside of the Plan, as certain services are *will be* considered competitive services *as of June 1, 2003. Although* one consistent element contained within each of the mandated plans is residence network access, *the Company has offered its first "package" with a separate access charge, which simply reflects the existing network access charges for access areas A, B and C. Therefore, the*

"package" does not bundle access and there is no reason to place it in the Residential basket. The "package" does include only usage, however, and if it is be included in the Residential basket, it will have to be priced consistent with the price index. This would also be consistent with the legislative directive that the statutory packages "result in savings for the average consumer." 220 ILCS 5/13-518(a). If it is priced as a new service, however, it cannot be placed in the Residential Basket, but must be assigned to the new Packages basket. ~~This particular element has traditionally been found within the Residential basket and is the cornerstone of residence services, without which no other type of service is possible. Each of the three mandated packages bundle residence network access with other services. In other words, you may not obtain one of the three packages without network access. Though two of the three mandated packages contain services not traditionally found within the Residential basket, we agree with Staff and the Company that these plans be placed within the Residential basket.~~

~~Staff correctly points out that each package mandated by statute includes access services and that most of the services contained within the statutorily mandated packages consists of services, if unbundled, would be in the Residential basket. Though not a perfect fit, including all the mandated packages within the Residential basket does make sense. Each package contains network access. Each package contains local usage. These statutorily mandated packages can be distinguished from SimpliFive and CallPak or other voluntarily provided calling plans that the Company may offer at its discretion. Voluntary plans may bundle network access with usage or they not. However, the mandated packages may not be offered without offering network access. As stated above, network access is the core element of residence service and therefore should not be extracted from the Residential basket simply because other service(s), bundled with network access may not neatly fit into the Residential basket. Further, we agree with Staff that by placing the mandated packages within the Residential basket, savings to consumers in the future and residential subscribers as a class, will continue under alternative regulation. Admittedly, by placing the mandated packages within the Residential basket together with other existing services, the Company has some level of flexibility when it comes to price. It may lower prices of other services in order to raise prices of mandated services. The Company however, is constrained within the Residential basket. As discussed immediately below, the likelihood of the Company decreasing the price of services currently found in the Residential basket, in order to increase the price of mandated packages, is significantly reduced given the lower margins of services historically found in the Residential basket. Therefore, we conclude the statutorily mandated calling plans be placed within the Residential basket.~~

~~GCI/City's suggestion of adding a new basket just for the mandated packages is interesting but is rejected. After HB 2900 was passed the parties were afforded an opportunity to comment on the impact of the new legislation on alternative regulation. Some parties acknowledged that the newly mandated plans would be very popular with consumers. No party indicated that the mandated plans would not be popular. Certainly the legislature must have envisioned the mandated plans would be well received. Assuming the mandated plans become as popular as many believe, removal of the those plans from the Residential basket and into their own basket will have consequences.~~

~~While it is true that should theses mandated services be placed into their own basket, there may be a greater likelihood for reductions in price over time due to the workings of the formula, i.e. the effect of the consumer dividend and productivity differential, it is equally true that core residential services will become fragmented within two baskets, Residential basket and GCI/City's proposed "Statutory" basket. In particular, a separate Statutory basket will cause the fragmentation of residential network access. To divide residential network access between to baskets, would only serve to weaken or dilute its position within each basket. GCI/City also argue that by placing the mandated plans within their own basket, the Company will have no ability to manipulate their prices. GCI/City suggest that unless the mandated plans are removed from the Residential basket and placed within their own basket, the Company could raise the prices of the mandated plans and offset those increases with decreases to high margin services contained within the same basket.~~

As stated above, the ability to manipulate or increase the costs of services found in the Residential basket, including the mandated packages, is significantly lessened given the lower margins of other services historically found in the Residential basket. This is true especially when compared to those discretionary services found in the Other basket. Therefore, *given the need not to dilute the Residential basket, the greata variability in the Other basket and the high probability that packages will mix not only services presently in different baskets, but competitive services as well, we conclude that a new residential basket for packages be established. This will insure that the packages are not used to undermine the protections we have provided for the most basic and inelastic services, i.e. network access and usage.* ~~we reject GCI/City proposed addition of a Statutory basket.~~

We also reject the Company's alternative proposal of combining the Residential and Other baskets. Consistent with our conclusion immediately above, placement of traditional residence services contained with the Residential basket and the legislatively mandated packages together with services found in the Other basket would only serve to frustrate the legislative intent that rates for the packages would continue to result in saving for average ratepayers. Legislative intent would be frustrated if residence services including the mandated packages would be placed within a basket that contain vertical services that historically have high margins. ~~As Staff correctly points out, the Company could easily raise prices for the packages over time and still meet the basket pricing constraint by reducing prices of high margin services.~~

III. THE PEPO'S DISCUSSION OF THE DIRECTORY REVENUES ISSUE IS GROSSLY ABBREVIATED AND FAILS TO RECOGNIZE ACTION TAKEN BY THE GENERAL ASSEMBLY IN HB2900 THAT SUPPORTS THE GCI/CITY POSITION THAT THESE REVENUES MUST BE RECOGNIZED IN THE CALCULATION OF IBT'S REVENUE REQUIREMENT.

As GCI noted in its Initial Brief on the Impact of HB 2900, the new legislation included an amendment to section 9-230 addressing directory revenues and expenses that provides:

> In determining a reasonable rate of return upon investment for any public utility in any proceeding to establish rates or charges, the Commission shall not include ...(iii) after May 31, 2003, revenue or expense attributed to telephone directory operations, which is the direct or indirect result of the public utility's affiliation with unregulated or nonutility companies. (New language underlined.)

In this review proceeding, GCI/City recommended that in reviewing the effect of alternative regulation on AI's earnings, and for purposes of calculating the level at which AI's rates should be reinitialized on a going-forward basis, the Commission must impute directory revenues. See GCI Exceptions at 138-149; GCI Brief on Impact of HB 2900, at 1-2. Staff accounting witnesses likewise concluded that directory revenues should be imputed in AI's test year revenues should the Commission conclude that the Company's rates should be reinitialized. See Staff Ex. 7.0 at 4.

Based upon GCI/City witness Ralph Smith's detailed analysis of the Company's relationship and transactions with Ameritech Publishing In., the Ameritech affiliate that publishes Ameritech's Yellow Pages directories, GCI/City recommended that $126 million in directory revenues be included in the calculation of AI's revenues for the 1999 test year. GCI Ex. 6.2 at 31. The 43% return on equity AI achieved during the test year, as calculated by Mr. Smith, includes these imputed revenues.

Section 9-230, as amended by HB 2900, recognizes that directory revenues have been included in the rate of return of a public utility like AI (see Alt. Reg. Order at 101[4]), and allows those revenues to continue to be included in an assessment of AI's earnings

[4] The Commission's treatment of directory revenues was affirmed by the Court in Illinois Bell Telephone Co. v. ICC, 669 N.E.2d 919 (2d Dist. 1996) (unpublished slip opinion at 29-37). GCI/City Ex. 6.4.

until May 31, 2003. GCI's Brief on the Impact of HB 2900 noted that as the rate of return calculated in this docket and rates that will be set predate May 31, 2003, it is clear that the new Section 9-230 confirms GCI/City's position that directory revenues are appropriately included in assessing how AI has fared under alternative regulation and what rate of return it earned during the 1999 test year. Accordingly, GCI argued, the Commission should adopt GCI/City's recommendation that $126 million in directory revenues be imputed in AI's test year revenue requirement for purpose of assessing AI's rate of return under alternative regulation and for the purpose of rate reinitialization.

The PEPO, however, fails to comment upon this argument, let alone acknowledge GCI's position articulated in the HB 2900 Brief. Moreover, while the PEPO inserted the positions of the parties with respect to the adjustments proposed by Staff and GCI/City should rate reinitialization occur, the discussion of the Directory Revenues Issue is particularly abbreviated. The ALJs truncated discussion of this important issue fails to provide a minimal analysis of the issue, let alone any of the details necessary to understand the Staff/GCI proposals.

PROPOSED LANGUAGE

Accordingly, the ALJs' discussion of this issue at page 123-124 of the PEPO should be stricken and replaced with the language found at pages 138-149 of GCI/City's Exceptions. In addition, following language should be added:

In their Brief on the Impact of HB 2900, GCI argues that the recent amendment of Section 9-230 of the Act recognizes that directory revenues have been included in the rate of return of a public utility like AI (see Alt. Reg. Order at 101[5]), and allows those revenues to continue to be included in an assessment of AI's earnings until May 31, 2003. GCI's Brief on the Impact of HB 2900 noted that as the rate of return calculated in this docket and rates that will be set predate May 31, 2003, it is clear that the new Section

[5] The Commission's treatment of directory revenues was affirmed by the Court in Illinois Bell Telephone Co. v. ICC, 669 N.E.2d 919 (2d Dist. 1996) (unpublished slip opinion at 29-37). GCI/City Ex. 6.4.

9-230 confirms GCI/City's position that directory revenues are appropriately included in assessing how AI has fared under alternative regulation and what rate of return it earned during the 1999 test year. Accordingly, GCI argues, the Commission should adopt GCI/City's recommendation that $126 million in directory revenues be imputed in AI's test year revenue requirement for purpose of assessing AI's rate of return under alternative regulation and for the purpose of rate reinitialization.

In the Commission Analysis and Conclusion section, found at pages 146-149 of GCI/City's Exceptions, the following should be added:

Finally it should be noted that the General Assembly's recent amendment to Section 9-230 of the Act supports our conclusion that imputation of directory revenues is appropriate. We concur with GCI/City that this amendment confirms that directory revenues are appropriately included in assessing how AI has fared under alternative regulation and what rate of return it earned during the 1999 test year.

IV. THE PEPO'S INTERPRETATION OF THE EFFECT OF HB2900 ON THE SERVICE QUALITY PENALTY PROVISIONS OF THIS ORDER IS FLAWED.

A. HB 2900 Does Not Affect the Commission's Authority to Order Customer Compensation Provisions That Are Stricter Than Those Outlined In New Section 13-712.

At page 185 of the PEPO, the ALJs reject both Staff's and GCI/City's call for increased customer compensation for OOS>24 hours and Installation Within 5 Days misses, arguing that the Commission may not impose more than the minimum amount of customer compensation outlined in new Section 13-712 of the Act because "it may only do so through the rulemaking process." PEPO at 185. This conclusion misinterprets the language of Section 13-712(c), which in no way diminishes the Commission's ability under Section 13-506.1 of the Act to fashion an alternative regulation plan "to fit the particular characteristics of different telecommunications carriers and their service areas." 220 ILCS 5/13-506.1(a).

Specifically, Section 13-712(c) requires the Commission to promulgate service quality rules that implement the customer compensation provisions of 13-712(d). While GCI/City agree with the PEPO's observation that the customer compensation provisions of Section 13-712 apply to all providers of noncompetitive telecommunications services, including companies like IBT operating under alternative regulation, nothing in HB2900 alters or diminishes the Commission's authority under Section 13-506.1 to implement provisions in the plan to "at a minimum...maintain the quality and availability of telecommunications services." 220 ILCS 5/13-506.1(b)(6). As such, the Commission is free in this proceeding to enact customer compensation provisions it believes are appropriate for IBT based on the record of this proceeding and the statutory directive of Section 13-506.1(b)(6). It should be noted, too, that the specific customer compensation dollar amounts listed in Section 13-712 are characterized by the General Assembly as "the minimum" amounts that should be applied to customer bills. Indeed, if the ALJs interpretation of the effect of the rulemaking directive in Section 13-712(c) was correct, the Commission would have to implement the annual benchmark penalty provisions for IBT through a rulemaking. Of course, this is not the case.

Additional support for this position is found in Section 13-712(e)(7), where the General Assembly specifically stated that the customer compensation provisions of the new act "are cumulative and shall not in any way diminish or replace other civil or administrative remedies available to a customer or a class of customers." Clearly, the legislature did not intend limit the Commission's ability under Section 13-506.1 to implement service quality standards, compensation and penalties in context of alternative regulation.

Accordingly, the PEPO should be modified as follows:

At page 185, first full paragraph, the sentence beginning with the word "Furthermore, ..." and the four paragraphs that immediately follow should be stricken and replaced with the following language:

New Section 13-712 of the Act established specific customer compensation amounts for noncompetitive telecommunications carriers' failure to meet basic service quality standards, including restoration of service due to outages, failure to install basic local exchange service within 5 days and failure to keep scheduled repair and installation appointments. The dollar figures established therein are characterized by the General Assembly as "the minimum" amounts that should be applied to customer bills. The record evidence in this proceeding details serious service quality failures in these critical areas during the life of the current price cap plan. Accordingly, we are inclined to order individual customer compensation levels for the above-mentioned service quality failures in the amounts recommended by both Staff and GCI/City.

B. The PEPO's Conclusion That New Section 13-712 Of The Act Requires Individual Customer Compensation Amounts To Be Deducted From Annual Benchmark Penalty Amounts Is Erroneous.

At page 190 of the PEPO, the ALJs cite Section 13-712 (c) of the Act, which requires the Commission to "take into account compensation or credits paid" by a carrier to its customers pursuant to Section 13-712 when developing service quality rules, and imposing fines, as a basis for offsetting compensation costs against penalties. 220 ILCS 5/13-712(c). In doing so, the PEPO mistakenly concludes that the word "shall" in Section 13-712(c) makes offset of the customer compensation amounts mandatory. The PEPO is wrong on this point.

Specifically, Section 13-712(c) states, in relevant part:

> In imposing fines, the Commission shall take into account compensation or credits paid by the telecommunications carrier to its customers pursuant to this Section in compensation for the violation found pursuant to this Section.

220 ILCS 5/13-712(c). The "shall" requirement in this passage refers to the Commission's obligation to "take into account" the compensation or credits "for the violation found pursuant to this Section." 220 ILCS 5/13-712(c). GCI/City agree with Staff's interpretation that this language constitutes an additional criterion to be considered by the Commission in setting penalties under this Section of the Act – not a requirement to offset the customer compensation credits when fashioning a service quality incentive mechanism in an alternative regulation review proceeding. The canon of statutory construction which provides that statutes are to be interpreted in light of their "plain meaning" dictates that the Commission not read language into a law that is not there. Indeed, if the General Assembly had wanted to mandate such an offset, the relevant passage would have read, "...the Commission shall offset customer compensation or credits..." rather than "shall take into account...".

In addition, as the ALJs have repeatedly recognized (but failed to implement in their analysis), the requirements of the new Section 13-712 must be construed with every other part or section so as to produce a harmonious whole. In re Estate of Bartolini, 674 N.E.2d 74 (1st Dist. 1996). Despite their acknowledgement that Section 13-506.1 remained intact with the passage of HB 2900, the ALJs, in effect, insist on diluting the broad authority the General Assembly provided the Commission in fashioning alternative regulatory plans that fit the particular characteristics of a particular company. By concluding that Section 13-712(c) requires a customer compensation offset for the penalties established in the revised alt. reg. plan, the ALJs erroneously diminish the Commission's authority under Section 13-506.1. The Commission should reject such a conclusion.

Accordingly, the PEPO should be modified as follows:

At page 190 the paragraph beginning with the words "Staff's construction of Section 13-712(c) is not persuasive....", as well as the next three paragraphs, should be stricken and replaced with the following language:

We agree with Staff and GCI/City that Section 13-712(c) cannot be read as to require the Commission to offset the individual customer compensation penalties from any service quality penalties arising from IBT's failure to meet the established benchmarks. HB 2900 in now way diluted the Commission's authority under Section 13-506.1 to fashion alternative regulatory plans that fit the particular characteristics of a specific company. The General Assembly has seen fit to require all noncompetitive telecommunications providers to compensate customers when they fail to deliver on the most basic of service quality measures. This requirement does not alter the Commission's conclusion, based on the record evidence of this docket, and our authority under Section 13-506.1 of the Act, that IBT shall not be permitted to deduct the customer compensation amounts paid out under Section 13-712(c) from the penalties outlined in this Order for failure to meet the 10 service quality benchmarks discussed herein.

V. **CONCLUSION**

For the foregoing reasons, and the reasons set forth in GCI/City's other briefs, GCI/City request that the Commission adopt the recommendations of GCI/City and adopt an Order consistent with GCI/City's Exceptions, Briefs and the arguments herein.

Respectfully submitted,

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October 18, 2001

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Illinois Bell Telephone Company	)	
	)	
Application for Review of Alternative Regulation Plan	)	Docket No. 98-0252
Petition to Rebalance Illinois Bell Telephone Company's Carrier Access and Network Access Line Rates	)	Docket No. 98-0335
Citizens Utility Board and People of the State of Illinois, ex rel. James E. Ryan, Attorney General of the State of Illinois, Complainants	)	
	)	
vs.	)	Docket No. 00-0764
	)	
Illinois Bell Telephone Company d.b/a Ameritech Illinois, Respondent	)	(consolidated)

NOTICE OF FILING

PLEASE TAKE NOTICE that on this date October 18, 2001, we have filed with the Chief Clerk of the Illinois Commerce Commission the enclosed Second Brief on Exceptions of GCI/City in the above-captioned docket by delivering it to United Parcel Service for next day delivery to Donna Caton, Chief Clerk of the Illinois Commerce Commission, at 527 East Capitol Avenue, Springfield, Illinois 62794.

Susan L. Satter
Assistant Attorney General

CERTIFICATE OF SERVICE

I, Susan L. Satter, an Assistant Attorney General, hereby certify that caused to be served the above identified documents upon all active parties of record on the attached service list by electronic mail on October 18, 2001 and by US Mail to all parties.

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